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SIPDIS

TREASURY FOR INTERNATIONAL AFFAIRS - CPLANTIER

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SENSITIVE

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TAGS: EFIN ECON TU
SUBJECT: The Anatolian Tiger Roars: 7.4% GDP Growth in 2005

1.(U) Summary: Turkish Statistical Agency (TUIK) announced 7.4% GDP growth (7.6% GNP) for 2005, well above expectations and the 5% program target. Surprisingly high (10.2%) growth in the fourth quarter, with the construction sector the star performer, raised the full-year growth figure and surprised analysts. Per capita GNP exceeded $5,000 for the first time, and average GNP growth since the 2001 crisis is now 7.8%. The strong growth provides a dramatic counterpoint to business complaints, mostly in export sectors, and is likely to reinforce the need for tight fiscal policy and make it harder for the Central Bank to lower interest rates. End Summary.

Blockbuster Data Release

¶2. (U) Fourth quarter GNP data surprised the markets, which expected a 6.7 percent GNP growth for the fourth quarter and 5.79 percent growth for the year as a whole. According to the data released by the State Statistical Agency (TUIK), fourth quarter GDP and GNP rose by 9.5% and 10.2%, respectively -- well above the market consensus estimates. This surge of growth in the fourth quarter, combined with upward revisions in earlier quarters' data, put full-year real growth at 7.4% for GDP and 7.6% for GNP. Both for the fourth quarter and the full year, the star performer was the construction sector, which grew 14.8% in the fourth quarter and 21.5% on the year in real terms. The construction boom and continued strong durables sales reflect Turkey's credit boom, as interest rates fell in 2004 and 2005 to affordable levels after years in the stratosphere.

¶3. (U) On the demand side, private sector consumption increased by 16.7% y-o-y, marking the highest annual growth rate recorded since 1995. However, investment spending grew even more: gross fixed capital formation grew 33% in the fourth quarter and 24% on the year. GDP per capita exceeded the $5,000 level ($5,008) for the first time as total GDP reached $361.5bn.

What It Means

¶4. (U) The surprising strength of the Turkish economy in 2005 has implications for policy. First, it helps vindicate the IMF-sponsored tightening of fiscal policy in 2006, which the GOT accepted in the fall. Had fiscal policy not tightened, continued disinflation and control of the current

account deficit would be that much harder. Strong growth is also likely to bolster the IMF's arguments in favor of continued fiscal austerity and against tax cuts like the GOT's recent VAT rate cut for the textile sector.

¶5. (SBU) Higher-than-expected growth would also argue for tighter monetary policy to damp down inflationary pressures. This is likely to slow the Central Bank's expected rate-cutting path, despite declining inflation. On the other hand, Tolga Ediz of Lehman Brothers points out that the persistence of strong growth despite the Central Bank's disinflationary tightening suggests a better inflation-growth trade-off than had been factored into the Bank's forecast.

¶6. (SBU) The strong growth also has interesting implications for the debate over Turkey's burgeoning current account deficit and the controversy over the GOT's decision to replace outgoing Governor Serdengecti. Despite a drumbeat of exporter complaints about Serdengecti and the allegedly overvalued exchange rate, the strong growth vindicates his policies, as does the strong investment spending. World Bank economist Rodrigo Chavez pointed out to us that Turkey's continued strong investment supports the argument of Willem Buiter of the Centre for European Policy Studies that the current account deficit represents increased investment more than increased consumption. Buiter argued (before the growth data were released) that Turkey's current account deficit was sustainable in a fast-growing economy and that the increased private investment that is a major driver of the deficit is a much-needed positive.

Shot in the Arm for GOT

¶7. (SBU) Even though the strong growth data will strengthen the IMF's argument for fiscal discipline, the GOT can only be pleased about the remarkably strong growth data, which strengthen their credentials as successful stewards of the economy.

McEldowney